THE U.S. ROLE IN LATIN AMERICA'S UNFINISHED ECONOMIC REFORM AGENDA

Testimony of

Jerry Haar

Professor and Senior Fellow
Knight-Ridder Center for Excellence in Management and
Pino Global Entrepreneurship Center
College of Business Administration
Florida International University

Before the

Subcommittee on the Western Hemisphere

U.S. House of Representatives

"U.S. Diplomacy in Latin America"

Washington, D.C.

July 27, 2005

Thank you Mr. Chairman and distinguished Members of this Subcommittee for inviting me to testify before you today.

Before addressing the U.S. role in Latin America's unfinished economic reform agenda, I wish to address the vitally important context of this theme.

From the beginning of my graduate studies of Latin American economics and politics at Columbia University more than three decades ago through the present time, the one refrain I have heard most often when the issue of Hemisphere relations comes up is: "The United States does not pay enough attention to Latin America!"

Contrary to popular belief, this lament (and admonishment) is dead wrong. For more than four decades, a steady flow of billions of dollars of U.S. assistance (bilateral and multilateral), private investment, NGO resources, and philanthropic donations to Latin America and the Caribbean have clearly demonstrated significant attention to the region. From John F. Kennedy's Alliance for Progress, to Ronald Reagan's Caribbean Basin Initiative, to Bill Clinton's assistance to Mexico during the 1995 peso crisis and the launch of the Summit of the Americas process, through George W. Bush's Millennium Challenge Account and support of CAFTA and the FTAA, both Democrat and Republican administrations have manifested genuine concern for the well-being of our neighbors to the South.

I submit that the Western Hemisphere's problems exist not because the United States does not pay enough attention to Latin America and the Caribbean but because the *region does not pay enough attention to itself and its own problems—99% of which are homegrown.* It is far easier for our neighbors to the South to displace their frustrations towards the "Colossus of the North," whining, moaning, handwringing, and begging, then for them to embark upon the path of self-reliance, good governance, institutional reform, social justice, and democratic capitalism. With the exception of Chile and Trinidad and Tobago that highway remains the road less traveled for most of the Americas.

If there is a one factor that largely explains political and economic success and failure in Latin American and Caribbean nations--not only in recent times but since independence nearly two hundred years ago--it is *leadership*. And while the U.S. has a sordid past in influencing elections and backing friendly despots (particularly in Central America), the scoundrels, thieves, thugs, and incompetents who have paraded their way into a Latin American Hall of Shame during the past decade were elected to power by their own people--Aristide, Alemán, Fujimori, Menem, and Chávez being the most infamous.

Within this "rogues gallery" of elected leaders, the most tragic case of all is Venezuela—a resource-rich nation presently ruled by an authoritarian and megalomaniacal buffoon who sees himself as the reincarnation of Simón Bolívar, Venezuela's nineteenth-century liberator. With a copy of Fidel Castro's totalitarian playbook at his bedside, Lt. Col. Chávez has committed slow motion larceny of democracy, packing the Supreme Court, manipulating elections, harassing the press, taking control of the central bank, organizing civilian militias ("territorial guards") and intimidating and brutalizing those who stand in his way of creating a "socialist paradise" (the quintessential oxymoron!). Sky-high oil prices of over $58 per barrel and cohorts of Cuban intelligence agents, health workers, and teachers enable the Venezuelan leader to consolidate his rule in a country where poverty rates and infant mortality have increased since the former coup leader came to power and where the average citizen lives worse than his or her grandparents did. With high unemployment and underemployment, the flight of billions of dollars in capital, the closing of over 7,000 private companies—half the country's industrial sector—and a significant drop in oil sector productivity, Venezuela's autocratic president is wreaking havoc on a nation once considered South America's strongest democracy.

It is vital to note that the materials, machinery, and assembly of this badly-designed, poor quality, and ill-fitting *chavista* garment are "100% Made in Venezuela." No U.S. inputs here. Hugo Chávez and his followers are the end-game of a morally bankrupt political system in which two political parties (Acción Democrática and Copei) and their kleptocratic infrastructures treated the nation's resources as a giant *piñata* for nearly three decades. With the full support of the nation's elites and the *nouveau riche*, these two parties and the "nanny state" they established--fueled by oil largesse--created a society of conspicuous consumption, corruption, moral decay, and a blatant disregard for the poor and disadvantaged. Ergo, if Chávez did not exist, he would have had to be invented.

Turning to Latin America's unfinished economic reform agenda, the region's record is one of mixed performance. On the positive side, the last two decades have witnessed the adoption and implementation of neoliberal reform measures: prudent fiscal and monetary policies, the selling off of state enterprises, and economic liberalization (trade, investment, finance). Inflation is in check in most countries, primary school enrollments have been rising, infant mortality is down, life expectancy is up, and poverty rates (although not inequality levels) have fallen.

On the other hand, the region has only partially implemented the macroeconomic reform agenda of the Washington Consensus and performed poorly in addressing relevant non-economic problems. In their quantitative study *Reform and Growth in Latin America: All Pain, No Gain?,* IMF economists Eduardo Fernández-Arias and Peter Montiel found insufficient depth and breadth of macroeconomic reform and a lack of structural and institutional second generation reforms. Much remains to be done in the areas of tax reform, property rights, and deregulation, as well as rural education, social safety nets, infrastructure, and public services.

As Latin America confronts the daunting economic challenges facing it, how can the U.S. best support the region's quest for economic freedom, growth and development in the Western Hemisphere? Quite simply by addressing four priority areas:

1. **Economic liberalization**. Ensure continued, deeper efforts at macroeconomic reforms, including arenas in which there has been slippage in recent years, such as public sector financial management. In countries like Costa Rica and Uruguay, for example, the federal government owns and controls utilities; and in Mexico and Colombia, the government dominates and greatly restricts foreign participation in

the oil sector, despite the irrefutable evidence that privatization efforts would significantly boost national wealth. The U.S. should intensify its support of trade, investment, finance, and services liberalization—not only regionally, bilaterally, and multilaterally, but *unilaterally* (as Chile wisely undertook). Other than the lack of political will, there is nothing preventing the nations of the Americas to design and implement sweeping measures to make their economies most welcoming and attractive for foreign and domestic business alike. Economically and commercially it is short-sighted and foolhardy to wait for the FTAA to become a reality (probably a year or more from now) or the WTO's Doha Round to be completed (most likely at the time of the next appearance of Halley's Comet) before acting. Specifically in the trade area, the U.S. should work with Hemisphere nations to implement the FTAA business facilitation measures agreed to at the 1999 Toronto Trade Ministerial meeting—customs-related measures that traders agree are of greatest and most immediate benefit to them.[1]

2. **"Second Generation Reforms."** Two decades' experience with neoliberal economic reforms demonstrates clearly that liberalizing trade and instituting prudent fiscal and monetary policies are necessary but insufficient conditions for curing societal ills and creating economic opportunity. More important is the need to put in place "second generation" reforms—non-economic measures that address needs and bottlenecks in the areas of education, health care, housing, social services, and infrastructure. Development assistance is responding to this challenge; however, the U.S. should strongly urge governments in the region to do far more in allocating revenues to attack problems such as poorly funded schools and vocational training centers, inadequate primary health care, and outmoded transportation systems. Market economics can achieve its intended effects only if these other dimensions of societal development are afforded significant the attention and resources.

3. **Targeted development assistance.** In recent years, USAID has improved its management, monitoring, accountability, and program evaluation systems. It should continue to support cost-effective, results-oriented projects and programs that have high impacts, produce multiple effects, and incorporate best practices that can be disseminated and diffused throughout the region. Trade capacity building, small business assistance, improving governance, and rural development are prime examples. Leveraging resources through USAID mechanisms such as the Global Development Alliance and Development Credit Authority are an imaginative vehicle for mobilizing the resources of public-private alliances to

[1] These include in particular: streamlined procedures for the temporary importation of goods related to business travel; procedures to expedite express shipments; simplified procedures for low-value shipment transactions; accessible electronic systems for the trading community and a set of common data elements to foster expedited clearance procedures; dissemination of information on customs procedures, laws and regulations; and development of national codes of conduct applicable to customs officials.

stimulate economic growth. Other U.S. government entities such as the U.S. Trade and Development Agency (USTDA) are also supporting creative projects to achieve the highest return on invested resources. One such USTDA program about to get under way in Guatemala assists the leading export association (AGEXPRONT) by training their trainers who teach business skills and international trade to managers, support staff, and executives in small and medium size firms.

What Latin America does not need is a massive North-to-South wealth transfer program called for by economist Jeffrey Sachs in his book *The End of Poverty* (although *The Beginning of Fantasy* would be a more apt title). The region lacks the absorptive capacity to judiciously and effectively use a doubling of aid money. Moreover, this largesse would invariably lead to a cutback or suspension of locally financed reform efforts in recipient countries.

4. **Microeconomic reforms.** Attention towards economic reform efforts has focused almost exclusively on macro-level issues, ignoring the fact that micro-level issues are of even greater importance. These constitute the "electrical wiring" and "plumbing" of the political economy of nations and the grease that fuels (or clogs) the engine of growth. Microeconomic issues are also ones that are felt most directly by business, workers, and consumers. Foremost among the microeconomic issues in dire need of reform are: regulations, taxation, the administration of justice, labor, and financial services. To illustrate:

Regulations. The World Bank's *Doing Business in 2005* benchmarks business regulation in 130 countries—regulations that enhance or constrain business investment productivity, and growth. Latin America's performance, while not as miserable as Africa's, is poor nonetheless. Whereas bankruptcy proceedings can take 2 years in Mexico and Peru and 10 years in Brazil, countries like Hong Kong, the UK, and New Zealand enable creditors to recover bad debts relatively quickly. In Brazil it takes 152 different steps and five months to start a business versus 2 days in Australia, 3 in Canada, and 4 in U.S. Even in Russia, one can complete all the requirements for starting a business in less than a month. Regulatory burdens are most harmful to small businesses and start-ups—the largest private sector employers in Latin America.

Taxation and property rights. Steep value-added taxes (VAT), though easy to collect, elevate retail costs and depress sales. Argentina even taxes its own exports, further restraining domestic growth. Throughout the region, inadequate protection of property rights keeps poor citizens from titling real estate, denying them the right to sell it or use it as collateral for credit. Most tax systems are characterized by high rates and low collection. (Mexico for example collects only 12% of GDP from taxes, the lowest of any OECD country.) Regressive taxes like the VAT punish both the poor and the productive sector, where corporate tax rates at 35% are higher than China (15-24%), Malaysia (28%), and Japan (34%). It is not surprising that tax evasion and capital flight are rampant.

And what do taxpayers get for their tax dollar? Argentine economist Ricardo López Murphy summed it up when he complained that Argentines pay Swedish level taxes in exchange for public services of African quality.

Administration of justice and public safety. As for judicial reform, much still needs to be done. With a backlog in cases, the best judges money can buy, and incessant rule-bending and unreliable dispute settlement mechanisms, both local and foreign investors have little faith in the court system. In the area of public safety, criminal activity has been increasing in recent years. Criminal gangs in large major metropolitan areas like Rio de Janeiro, São Paulo, and Mexico City, and the infamous Mara Salvatrucha network in Central America are a threat not just to the citizens of the region—rich and poor alike—but to businesses as well, both domestic and foreign. A recent UN study on urban violence reveals that multinational corporations plan to invest more in Poland and the Czech Republic over the next five years than in Mexico—the main reason being "lack of security" in Mexico.

Labor. Many of the rules that govern labor markets in Latin America (and elsewhere) raise labor costs, create barriers to entry, and introduce rigidities in the employment structure. These include the exceedingly restrictive regulations on hiring and firing practices, as well as burdensome social insurance schemes. While salaries may be low by industrialized nation standards, non-salary costs such as benefits, labor production taxes, and severance can actually double the cost of labor. Hiring a worker, like getting married, is relatively easy; firing a worker, like getting a divorce, is very lengthy and extremely costly.

Financial. Despite merger and acquisition activity and the widespread use of technology (including online banking), Latin American banking--consumer and small business--is grossly inadequate, complicated, and cumbersome. For the most part, bank activity is dominated by trading government paper. When they do provide financing, it is often in syndicate, for large preferred corporate borrowers. Were it not for the proliferation of credit cards and retailers providing credit to customers, or setting up their own financial service firms like Elektra's Banco Azteca in Mexico or kiosk banking like Brazil's Lemon Bank, the working class would have even less access to consumer goods.

Overall, the greatest contribution the U.S. could make to shore up political and social stability in the region and enhance the likelihood that the benefits of neoliberal economic reforms are felt by all in society, not just a few, is to channel the greatest portion of its development assistance resources to institutional reform and exhort Latin American governments to do the same. Douglass C. North, a Nobel Laureate in economics, drives home this point in his compelling book *Institutional Change and Economic Performance*. Institutions provide the structures and delivery mechanisms for a society's social, economic, political, and legal functioning. If microeconomic reforms, so urgently needed, are to achieve their expected results, Latin American nations must build efficient, effective, transparent, and accountable institutions. The U.S. government should be relentless, via the power of the purse and incessant jawboning, in getting this message across and increasing the likelihood that our Hemisphere neighbors will act.

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The greatest challenge Latin America faces in overcoming the impediments to economic freedom, growth, and development is *cultural*. Lawrence Harrison and Samuel Huntington make this compelling argument in their edited volume *Culture Matters*, along with the contributions of nearly two dozen other academic experts. Despite progress in the region in political, economic, social and legal development, Latin America is still experiencing a 500 year-old hangover from Spanish and Portuguese colonization which transplanted to the New World the Iberian Peninsula's same repressive, exploitative, unjust, and corrupt societal structures and institutions.

Cultural change can and does take place the world over; and if Latin America can broaden, deepen, and expand its reform agenda and ignite across the region what George Gilder calls "the spirit of enterprise"—namely, entrepreneurship—our Hemisphere neighbors will experience the progress they hope for.

The U.S. can support, guide, encourage, and applaud these efforts but it cannot substitute the self-reliance and responsibility that the region's public and private sectors and citizenry in general must embrace and manifest themselves.